
IN THE CHANCERY COURT OF TENNESSEE, KNOX COUNTY
SIXTH JUDICIAL DISTRICT AT KNOXVILLE

STATE OF TENNESSEE,

Plaintiff,

v.

STRATEGIC TELECOM SYSTEMS,

INC., a Tennessee corporation,

Defendant.

COMPLAINT

This civil action is brought in the name of the State of Tennessee, by and through John Knox Walkup, Attorney General and Reporter ("Attorney General"), under Tenn. Code Ann. §§ 47-18-108(a)(1) and 47-18-114, at the request of the Division of Consumer Affairs of the Tennessee Department of Commerce and Insurance (the "Division"), having reason to believe that the Defendant named herein has violated the Tennessee Consumer Protection Act of 1977, Tenn. Code Ann. §§ 47-18-101 *et seq.*

JURISDICTION AND VENUE

1. This Court has jurisdiction under Tenn. Code Ann. § 47-18-108 and other applicable law. Venue is proper in Knox County, according to the provisions of Tenn. Code Ann. § 47-18-108(a)(3), because it is a county in which Defendant has conducted business. Further, the corporate headquarters of Defendant are located in Knox County. Plaintiff has provided Strategic Telecom Systems, Inc. ("STS" or the "Company") with ten days notice of the Attorney General's intention to file this action consistent with Tenn. Code Ann. § 47-18-101(a)(2). (*See, Exhibit A, Affidavit and Verification of Mark Williams, Director, Division of Consumer Affairs, Department of Commerce and Insurance*).

PARTIES

2. John Knox Walkup, the Attorney General and Reporter, at the request of the Director of the Division of Consumer Affairs, brings this action in the name of the State of Tennessee under Tenn. Code Ann. §§ 47-18-108 (a)(1) and 47-18-114, and pursuant to his common law authority.

3. Upon information and belief, STS is a Tennessee corporation, formed in May of 1995. Its principal place of business is 6420 Baum Drive, Knoxville, Tennessee 37901.

FACTUAL ALLEGATIONS

4. STS sells telecommunications products, primarily prepaid long distance telephone calling cards, through a multi-level marketing plan.

5. The majority of STS revenues come from current STS sales agents (labeled "Independent Representatives" or "IR's") recruiting new Independent Representatives to join STS. New recruits must complete a one-page application and contract, and pay \$99 for a "Career Manual," videotapes and sales literature. In order to earn "commissions," Independent Representatives must purchase products, typically prepaid long distance telephone calling cards. Products must usually be purchased in \$200 or \$600 increments. Once an Independent Representative has purchased the required amount of a product, the IR earns further "commissions" by recruiting new Independent Representatives who are, in turn, required to buy a certain amount of a product from STS.

6. STS represents to potential new recruits that it will sell them prepaid telephone cards at "wholesale" prices. STS claims that by using STS calling cards, long distance customers can save up to 60% on long distance charges. In fact, the "wholesale" price at which STS sells prepaid long distance calling cards exceeds competitive retail market prices.

7. STS also represents to potential new recruits that the prepaid telephone cards are easily sold at retail for a profit. STS does not have a reasonable basis for this claim, and cannot substantiate that there is a large market for its prepaid telephone cards. STS does not maintain any documentation of retail sales in the ordinary course of business.

8. STS also represents to potential new recruits that certain of its telephone cards hold intrinsic value as collectibles, comparing the prepaid telephone cards to collector sports cards. STS does not have a reasonable basis for this claim, and cannot substantiate that any of its cards have intrinsic value as collectibles.

9. In attempting to recruit new Independent Representatives, STS has made and condoned the making of earnings claims and implicit earnings claims. STS does not have a reasonable basis for these earnings claims, and cannot substantiate that the claims accurately reflect what the average participant may expect to earn.

10. When an Independent Representative orders products from STS, the products are paid for at the time the order is placed. STS has charged buyers' credit accounts prior to shipment of ordered products, failed to provide shipment delay notices, and failed to honor cancellation notices, in violation of the Federal Trade Commission Mail Order Rule, 16 CFR 255.

11. STS has also produced, distributed and sold long distance prepaid telephone cards that do not work or that expire within an unreasonably short period of time. Some cards sold by STS did not work, or were canceled, because STS failed to maintain its accounts with long distance service providers. Still other cards were forwarded to an adult entertainment line.

12. In its promotional materials, STS states that the company's policy is to provide a 90% refund for products returned in a "resalable and reusable" condition. But STS places unreasonable restrictions upon an Independent Representative's right to receive a refund, which are not adequately disclosed to potential new recruits.
13. Hundreds of Independent Representatives who have complied with the unreasonable restrictions placed upon their right to return products for a refund have not been paid the promised refund.
14. STS misrepresents, and fails to adequately disclose, the consequences of an Independent Representative's withdrawal from STS. As a result, STS has manipulated and withheld payment of commissions and refunds, and has retained thousands of dollars owed to its participants.
15. STS represents to potential new recruits that it will provide superior customer service, training, and support to its Independent Representatives. But STS has failed even to reasonably address the communications, complaints, customer service needs, inquiries, and requests of its Independent Representatives.
16. STS participants have filed more than one thousand complaints against STS with Tennessee Department of Commerce and Insurance, Division of Consumer Affairs. The majority of these complaints involve one or more of the following problems:
- (A) STS telephone cards do not operate properly;
 - (B) STS did not adequately address the communications, complaints, customer service needs, inquiries, and requests of its independent representatives; and
 - (C) STS has not made refunds due under the terms of STS agreements. Although STS has resolved some of these complaints, many complaints remain unresolved.
17. STS uses and employs a chain referral sales plan in connection with the sale of its products through which buyers and prospective buyers are offered the opportunity to purchase goods or services and, in connection with the purchase, receive the seller's promise or representation that the buyer shall have the right to receive compensation or consideration for furnishing to the seller the names of other prospective buyers. The receipt of compensation or consideration is contingent upon the occurrence of events subsequent to the time the buyer purchases STS merchandise or goods.
18. STS sells and offers to sell to new recruits the right to participate in a pyramid distributorship.
19. Independent Representatives' commissions are based solely on recruiting and wholesale orders from STS. Therefore, Independent Representatives can and do receive commissions without ever making a retail sale of any product produced or marketed by STS.
20. Defendant's operation of a multi-level marketing program or business opportunity, and its sale of products including prepaid calling cards, constitute "trade" or "commerce" and the offering of or providing of "goods" and "services" as defined in Tenn. Code Ann. §§ 47-18-103(5), 103(8), and 103(9). As a result of Defendant's actions as described herein, consumers have lost money and property, and additional consumers may continue to suffer losses.

VIOLATIONS OF THE LAW

For each of the following Counts, Plaintiff realleges Paragraphs 1 through 20:

COUNT I

21. By misrepresenting the market value of STS prepaid telephone cards, Defendant has violated Tenn. Code Ann. §§ 47-18-104(a), 104(b)(5), 104(b)(7), and 104(b)(27).

COUNT II

22. By misrepresenting the potential and expected earnings of new STS Independent Representatives, Defendant has violated Tenn. Code Ann. §§ 47-18-104(a), 104(b)(5), and 104(b)(27).

COUNT III

23. By taking orders for STS products and (1) charging buyers before the products are shipped, (2) failing to provide shipment delay notices, and (3) failing to honor cancellation notices, Defendant has violated the Federal Trade Commission Mail Order Rule, 16 CFR 255, and Tenn. Code Ann. §§ 47-18-104(a), 104(b)(12), and 104(b)(27).

COUNT IV

24. By selling products that do not work or that expire within an unreasonably short period of time, Defendant has violated Tenn. Code Ann. §§ 47-18-104(a), 104(b)(5), 104(b)(7), and 104(b)(27).

COUNT V

25. By misrepresenting and violating its refund policy, Defendant has violated Tenn. Code Ann. § 47-18-104(a), 104(b)(5), 104(b)(12), and 104(b)(27).

26. By misrepresenting and misapplying the penalties for withdrawing from STS, Defendant has violated Tenn. Code Ann. §§ 47-18-104(a), 104(b)(5), 104(b)(12), and 104(b)(27).

COUNT VI

27. By misrepresenting the extent to which it would address the communications, complaints, customer service needs, inquiries and requests of independent representatives, Defendant has violated Tenn. Code Ann. § 47-18-104(a), 104(b)(5), 104(b)(12), and 104(b)(27).

COUNT VII

28. By employing an illegal chain referral sales plan, Defendant has violated Tenn. Code Ann. §§ 47-18-104(a), 104(b)(18), and 104(b)(27).

COUNT VIII

29. By selling and offering to sell the right to participate in a pyramid distributorship, Defendant has violated Tenn.

DEMAND FOR RELIEF

WHEREFORE, PREMISES CONSIDERED, THE STATE OF TENNESSEE PRAYS:

- (1) That this Complaint be filed without cost bond as provided by Tenn. Code Ann. §§ 20-13-101, 47-18-108 and 47-18-116.**
- (2) That process issue and be served upon STS pursuant to Tenn. Code Ann. § 20-2-201, requiring it to appear and answer this Complaint.**
- (3) That this Honorable Court adjudge and decree that STS has engaged in acts or practices in violation of the Tennessee Consumer Protection Act, Tenn. Code Ann. §§ 47-18-101, *et seq.*, as previously set forth.**
- (4) That this Honorable Court permanently enjoin STS from directly or indirectly engaging in the unfair and deceptive practices alleged in this Complaint.**
- (5) That this Court make such orders or render such judgments as may be necessary to provide full restitution including statutory interest and to otherwise restore to any person any ascertainable losses suffered by reasons of the alleged violations of the Tennessee Consumer Protection Act.**
- (6) That the Court enter an injunction rescinding all contracts between STS and its independent representatives.**
- (7) That the Court enter an injunction against STS requiring it to disgorge all profits generated from the unlawful scheme and plan alleged in this complaint.**
- (8) That the Court appoint a Special Master to inventory STS's bank accounts, monitor STS's operations, make reports to the Court regarding the assets, obligations, liabilities, claims and financial status of STS and, if warranted, its affiliates.**
- (9) That the Court, after evaluating the report of the Special Master, appoint a receiver to take possession of all of STS's assets and to liquidate STS's assets, if necessary, in conformity with the orders and at the direction of the Court.**
- (10) That the Court adjudge and decree that the STS is liable to the State for the reasonable costs and expenses of the investigation and prosecution of the STS's actions, including attorneys' fees, as is provided by Tenn. Code Ann. § 47-18-108(b).**
- (11) That the Court adjudge and decree that the STS pay civil penalties of not more than one thousand dollars (\$1,000.00) per violation of the Tennessee Consumer Protection Act to the State as provided by Tenn. Code Ann. § 47-18-108(b).**
- (12) That all costs in this cause be taxed against STS.**
- (13) That this Court grant Plaintiff such other and further relief as this Court deems just and proper.**

14991